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SHOULD I OUTSOURCE ACCOUNTING TASKS AND MOVE TO THE CLOUD? - CASE KLUUVIN APTEEKKI

Teaching Case

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Abstract

This teaching case considers Kluuvin Apteekki, a small pharmacy business whose CEO faces critical decisions whether or not (1) to outsource its accounting processes and (2) to start using cloud-based accounting information systems. The main learning outcome of the case is related to the development of the skills and competencies in creating a strong business case for the IT-enabled business process outsourcing based on the selected literature and prior experience.

Keywords: Outsourcing, Cloud Based Information Systems, Selective Outsourcing, Accounting Processes.

1 Introduction

It is 6 pm on Saturday and Kluuvin Apteekki, a pharmacy in the downtown Helsinki has closed an hour ago. Kluuvin Apteekki's sole owner, CEO and chief pharmacist Pia Moksi is sitting in her small office at the back of the pharmacy. Other employees already left home and Pia has just finalized the closing routine, the weekend is finally here. Even though it has been a very long week, Pia is not in a hurry to leave. This is one of the rare moments when she has some time to reflect on what has been going on in the pharmacy during the week and think about the future. She noticed already a while ago that, in the last couple of years, moments like this have become a rare luxury.

Managing a pharmacy in the highly competitive environment of the Finnish capital was never an easy task. However, as business grew, the amount of administrative work related to the business, especially accounting tasks, got out of hands. As she performed all the financial administration tasks herself in-house, increased workload started to eat away her valuable time, which should be spent on more important tasks in the management of the business.

In the past, Pia had encountered advertisements by different accounting firms. Recently, she attended the Pharmacy Days event where she heard some success stories of accounting outsourcing from her colleagues in the industry. All that got Pia thinking whether it was time also for her to outsource. But

how to do it? A quick survey of her entrepreneur friends and a Google search for available service providers revealed seemingly unlimited number of options, all with their pros and cons. “What exactly should I outsource and why?”, “How do I choose the credible service provider?”, “What if it goes all wrong?”, “And what are those cloud-based services so many companies try to advertise so heavily?”, “Or maybe after all I am still better off, doing it myself?” There seemed to be more questions than answers, and very little time to think about them. All these questions in mind, Pia turns to you for guidance.

2 Setting the scene: Kluuvin Apteekki and accounting process

Kluuvin Apteekki is a privately owned pharmacy located in the heart of the Helsinki city. The company employs 16 people, which includes 7 fulltime workers, 2 certified pharmacists (higher degree), 3 pharmacists, a technician, and a technician trainee, as well as 9 part time employees, 2 pharmacists, a beautician, 2 technicians and 4 pharmacist trainees (see Figure 1). The turnover of the company in 2012 was around 2.2 million euros.

Kluuvin Apteekki was established in November 2009 and has been growing since. In addition to the main pharmacy in the city centre, Kluuvin Apteekki recently added another small pharmacy in the district of Merihaka, which employs one of the pharmacists and contributes 419 thousand euros to the turnover.

The pharmacy business in Helsinki is very competitive and at the same time, highly regulated by the state. Prescription drug sales and marketing are tightly controlled, so are the other aspects of business, such as location of the pharmacies, their density in particular areas as well as the number of stores each company can own simultaneously. All this leaves small space for creation of competitive advantage. Thus, Kluuvin Apteekki always tried to stand out by offering exceptional customer service and by organizing clever sales campaigns for items not regulated by state (e.g. beauty and personal care products). In addition, Pia has paid special attention to administrative efficiency to keep operation costs down.

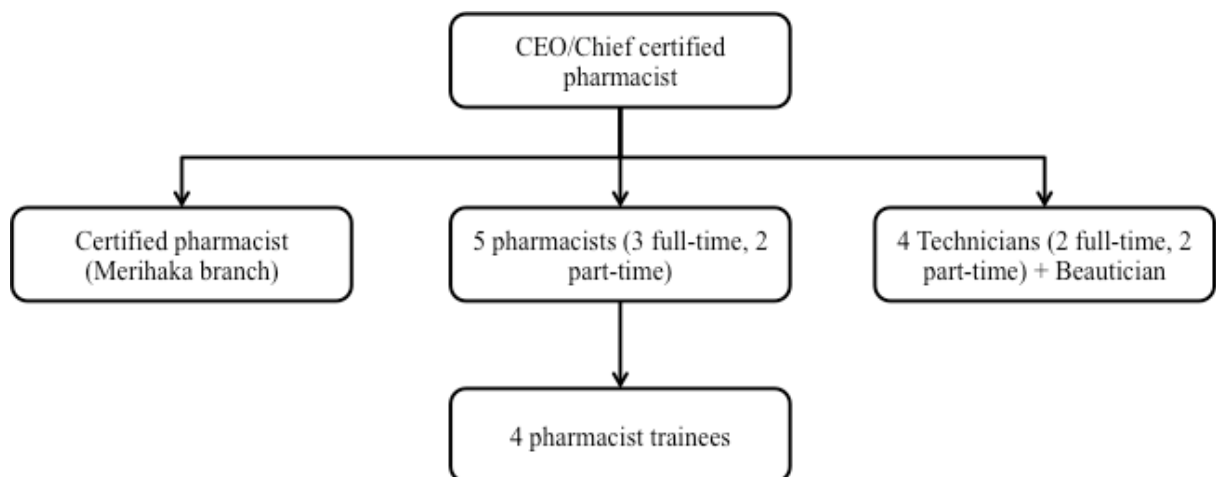


Figure 1. Organisational structure at Kluuvin Apteekki

2.1 Accounting process in Kluuvin Apteekki

The overall accounting process in Kluuvin Apteekki consists of five main groups of tasks: *sales, purchases, payments, reporting and payroll*. Each of these groups of tasks consists of three to six tasks

that need to be completed, which add up to the 22 accounting tasks in total. Table 1 provides concise description of each group, the list of all processes are presented in Appendix 1.

Process group	Description
Sales	Sales represent a detailed itemization of sales made, presented in date sequence. It may also contain credits issued that reduce the amount of sales (e.g. for products returned by customers). The information in a sales ledger can be quite detailed, including such items as the sale date, invoice number, customer name, items sold, sale amounts, freight charged, sales taxes, value-added tax etc.
Purchases	A purchase ledger is a sub-ledger in which all purchases made by Kluuvin Apteekki are recorded. The purchase ledger shows which purchases have been paid for and which purchases remain outstanding. A typical transaction entered into the purchase ledger will record an account payable, followed at a later date by a payment transaction that eliminates the account payable.
Payments	Payments refer to all monetary transactions between Kluuvin Apteekki and third parties for the goods or services that are purchased by the company or additional fees and payments due.
Reporting	Accounting reports are referred to as periodic statements, which show financial position of a firm at a given time or over a stated period, resulting from its business transactions and operations.
Payroll	Payroll refers to the amount paid to employees for services they provided during a certain period of time and is crucial to the companies as payroll and payroll taxes can significantly affect the net income of the company.

Table 2. *Accounting tasks at Kluuvin Apteekki*

Even though the tasks are essentially the same across different companies, there is no silver bullet for accounting related problems as the nature of the task itself can vary greatly from company to company. Each accounting task has its own specifics, and depending on the company context, it may require different amount of information, workload, or expertise. For example, for a company with one or two permanent employees, processing of the payroll can be a non-issue, as the process would be mostly the same every month. However, for the company employing tens or even hundreds of part-time workers with fluctuating work shifts and high employee turnover the process can turn into a nightmare.

Pia Moksi is no stranger to the pharmacy administration with experience of nearly 20 years; first as a pharmacist and administrator of a pharmacy in a small town in Eastern Finland for 15 years and then last 4 years as the owner of Kluuvin Apteekki. She knows the ins and outs of the business. Therefore, at the start, she made a decision to do all of the accounting tasks herself in Kluuvin Apteekki. This made a lot of sense as Pia has a rich experience of dealing with pharmacy accounting under her belt as well as tens of hours spent on self-education, accounting courses, and seminars. Transferring all this expertise to an employee seemed like a huge task with an uncertain outcome.

Pia uses a number of information systems in order to deal with the tasks. In addition to the widely used Microsoft Excel, Pia has acquired a software specialized for pharmacies in Finland, in order to manage product, client and supplier registers, as well as keeping track of invoices. Even though Pia is no stranger to the electronic banking, the effort to digitalize invoicing process has not been successful. Last year, all of the 630 outgoing sales invoices were sent in paper format by postal services, and out of the 840 received purchase invoices, 80% were received in paper, 5% were received as an email

attachment and only 3% were received as structured e-invoices¹. One reason for this is the fact that Kluuvin Apteekki is a small player in the market with very small influence on either suppliers or buyers to persuade them to switch to e-invoicing. Big suppliers usually enforce their mode of invoicing to the smaller buyers, as well as their own information systems to process them. The pharmacy business is regulated and there are very few suppliers to deal with, thus Kluuvin Apteekki does not always have an alternative. On the positive side, the suppliers remain unchanged throughout the years, making the processing of their invoices relatively easy, once the invoicing method is adopted.

Payroll processing in Kluuvin Apteekki is quite complex as 9 out of 16 employees work part-time. On average, part-time employees work three six-hour shifts per week. However, this varies somewhat depending on the workload and availability of workers. Therefore, Pia has to record hours performed by workers every day. State legislation and collective agreements in the pharmacy industry also oblige employers to keep track of things like overtime work, public holidays, evening hours, and employee experience. These need to be factored in when paying salaries. Irregularities such as sick and maternity leaves add to the administrative burden, as they have to be processed accordingly. The payroll is also very sensitive to inaccuracies, as it deals directly with the employees' paycheck. Unpaid hours or missing overtime pay may cause tensions very quickly and, therefore, would require swift action to minimize the damage to employee morale.

On one hand, tasks related to reporting are less frequent than any other process in the accounting. On the other hand, they are the most difficult and complex to process. Books need to be closed in the end of each financial period and everything has to be checked thoroughly. Errors in the reporting process might have far-reaching consequences, and therefore, Pia considers them to be associated with high risk. For example, the calculations have to be done carefully in order to deduce the right amount of tax to be paid. The errors in annual reports may also lead to the heavy fines from tax authorities. Apart from the mathematical precision and attention to the detail, reporting requires good knowledge of the tax regulations and a vision related to the financials of the company, as those allow company to efficiently invest its incomes to the development of the business and minimize the amount of the taxes paid. Moreover, tax regulations change from year to year and, therefore, Pia thinks that the person doing to the reporting process needs to be trained yearly to keep up to date on these changes in tax legislation.

3 Outsourcing of accounting

Having thought about processes within her pharmacy for some time on that Saturday evening, Pia started to realize that she needed to act soon. Maintaining the status quo in this situation could jeopardize the growth of her business as well as have a damaging effect on the efficiency of operations. Throughout these four years, she has been several times coming back to the idea of outsourcing some of the tasks in accounting. The conversations during the Pharmacy Days earlier this year motivated her to come back to this question once again. However, this time she decided to go one step further. Pia conducted Internet research for outsourcing options, surveyed her friends and colleagues with outsourcing experience and even met representatives from a couple of accounting companies offering their services. In spite of the rich information Pia received as a result of the effort, the decision seemed to be more complex than ever. For one, Pia was now certain that outsourcing is

¹ Structured e-invoice refers to an invoice that is transmitted electronically in a structured format. Structured e-invoice may be in EDI (electronic data interchange)- or XML (extensible mark-up language)-formats. The essential difference between structured e-invoice and non-structured invoice is that a structured e-invoice is machine-readable.

not a binary decision with only *yes* and *no* answers. Contrary to that, outsourcing came in all shapes and sizes. Some of the people she talked with, outsourced most or all of the accounting, while others had delegated just the payroll and reporting to the third party. Yet another contact admitted that he had settled for outsourcing invoicing, performing the rest of the tasks by himself. What made matters worse was the fact that everyone claimed that their way of working was the best balance between potential risks and benefits of outsourcing.

As a result, Pia decided to focus on her own situation and hope that the right solution would emerge in the end. The two main reasons she considered to outsource in the first place were (1) the desire to have more time to concentrate on the core business of pharmacy, and (2) the aim to cut costs.

One of the biggest promises of outsourcing is the ability of the company to concentrate on the core competences. Focusing on core competencies, in turn, frees up resources to be used more productively. This benefit was clear to Pia. She herself felt that she could have been able to invest so much more time on thinking about growth opportunities and strategic choices for her pharmacy rather than spending time on accounting processes. Pia also remembered how much outsourcing helped some of her colleagues to concentrate on the management and strategy development.

“And besides, you get access to the professionals, they make their living from accounting, they surely are better at these things than us, pharmacists” – Pia recalled the comment from Sami, a fellow pharmacy owner she met during Pharmacy Days. On one hand this sounded logical, after all she did not have a formal accounting or business education and her experience, however long, was limited to her particular pharmacy. Therefore, a professional accountant should provide a quality service, and perhaps one or two tricks that would improve the efficiency of the process. On the other hand, doing accounting on her own, she is in control of the situation. Can she trust an external accounting company with such critical processes just like she trusts herself? “It takes me a long time to make sure there are no inaccuracies and errors. In other words, will some stranger have the same commitment to my business as I do?” – Pia thought. Besides, she heard some stories from her friends who had to change their accountants, due to the fact that the service provider had been incompetent or irresponsible.

Another big motivator for outsourcing seems to be cost reduction. “Accounting takes a lot of my time, and I am too expensive” – thought Pia. “But, what cost savings are we talking about?” – Pia asked herself trying to understand how this benefit would be relevant to her pharmacy business. Estimating the costs of outsourcing seemed to be a difficult task. While on the surface everything was clear, her meetings with accountants left Pia suspicious. There were fixed fees, like software licenses and basic monthly service fee, but there also seemed to be a potential for some hidden costs. “Well, it is difficult to say like that, it all depends on the workload, like number of invoices your company needs to process, or whether it is the end of the financial period” – answered a representative of one of the accounting companies to Pia’s question about the precise cost of the service. “But, the fee is always fair and our clients are always happy” – he added. Pia thought, “Maybe I am expensive, but at least I know *how* expensive.”

The abovementioned risks seemed potentially catastrophic in case materialized. Her pharmacy business is small and Pia would not be able to afford paying increased service fees. Additionally, accounting companies have multiple customers, many of which are much larger and potentially more interesting than her pharmacy. How would she ensure that an accounting service provider would take her interests into account and value their relationship? How can she ensure high level of quality and anticipate the increase in rates? Surely, a service contract would be made between the outsourcing company and a service provider but Pia is no lawyer, and fine print in the contract may always turn against her. “It was completely her fault and the law was on our side, but what could we do? Going to

the court would have been more time consuming and expensive. So we just switched to another firm“ – said Maria, Pia’s old colleague from the previous job, during a recent phone conversation.

All these questions were heavily weighing in her mind. If after the Pharmacy Days she was quite excited about the whole idea of outsourcing, after considering its risks, she was not anymore at all sure if this is the right decision. “But after all, it can’t be that bad, my friends and competitors have made it work.“ – thought Pia and continued “And I can really use all that free time I could get from getting rid of accounting.“ She could also start slow, try outsourcing some processes and continue with others by herself for a while. But how to choose which processes to outsource then? Based on what? What would be the optimal combination, or timeframe?

Maybe she needs to use those mystery cloud-based accounting information systems? Would they be able to substitute the choice of outsourcing? Or maybe she would use them in combination with outsourcing? This sounded like an interesting idea, so she decided to dig more about the cloud.

4 Cloud computing

If outsourcing had been on Pia’s mind for a longer time, cloud computing was a totally new concept to her. She came across the concept while researching into the options of accounting outsourcing. According to the local vendors of cloud-based accounting information systems such as Visma Solutions and Procountor International, their systems made accounting easier by greatly automating the process, integrating all the company data into one service, and allowing its users to receive the information in real time (Netvisor, 2013; Procountor, 2013). What is more, cloud-based accounting information systems also allowed its users to outsource accounting processes to the partner accounting service providers. “Because everything is on the Internet, it is all very flexible. You can freely choose the tasks you want to outsource and at the same time maintain control over the process, thanks to the real-time features provided by the system“ – the representative of the accounting company tried to comfort Pia, noticing a skepticism in her look.

All this sounded very attractive, but Pia did not want to take anything at face value. So she decided to find out more. More scientific oriented literature informed Pia that cloud computing refers to the information technology service model, where hardware and software services are delivered on-demand to customers across distributed IT resources and network in a self-service fashion, independent of the device and location (Marston, Li, Bandyopadhyay, Zhang, & Ghalsasi, 2011; Motahari-Nezhad, Stephenson, & Singhal, 2009). The main value of cloud computing for businesses derives from offering resources in an economical, scalable and flexible manner, which are affordable and attractive to IT customers and investors (Motahari-Nezhad et al., 2009). It can be argued that promising business benefits of the cloud resulted in high expectations. The industrial reports informed that cloud is a growing phenomenon. For 2013, the worldwide market forecast for public cloud services is estimated at \$129 billion, with a five-year compound annual growth rate (CAGR) of 17%. Compared with the forecast for all IT marketplaces in 2013 of \$2.7 trillion, cloud represents only 4.8% of the IT marketplace and is forecast to represent 7.7% in 2017 (Potter, 2013).

And again all this sounded interesting and promising if sometimes unclear and confusing. The great promises were backed up with clever jargon, numbers, and overall excitement. However, as Pia is looking for *the* solution for her business, she cannot tolerate any uncertainty. “‘Good enough’ is not good enough for me“ – thought Pia. Therefore, she decided to go beyond abstract benefits and concentrate on the concrete features of cloud computing.

First, cloud computing is associated with lower costs, as the whole service runs on the computers of the service provider. Also, cloud-based systems are delivered as Software-as-a-Service (SaaS), which

means that there are no costly investments into the software licenses, and the user can pay for everything based on usage. However, Pia has already invested in her software and any payment for the new system seemed like an additional cost. Also, accounting process is very small scale compared to the IT systems of large companies and, therefore, IT savings did not seem to be relevant in this case. Pay per use model, offered by some systems, was also suspicious to her as she already had to deal with possible hidden costs from accountants, and this seemed like another possible source of such costs. “You need to think the long term” - said the representative of the accounting company, “The demand for accounting services for the small business like you varies greatly and, therefore, paying for it per use would end up in large savings in the long term compared to the fixed fee.”

The other advertised benefits of cloud systems seemed to be centered on scalability, flexibility, and accessibility. Vendors of the cloud-based software claimed that their systems can integrate all the company's processes in the same place and allow access 24/7 from any Internet connected device. Furthermore, because the data does not have to be stored and processed by the clients' computers, services can be scaled in real-time. This meant that Pia could opt for minimal services at the beginning, but scale her usage as needed any time. All these benefits related to scalability and flexibility sounded very exciting. Pia thought that with the cloud based systems it would be much easier to expand her business and open new pharmacies as the software required for operations will be already accessible from day one! However, at the same time she had a mixed feeling. Powerful data centers, application integration, virtual business environments... Is all this still suitable for a small company like hers? Does she really need all these capabilities, which no doubt come at a fee? Is there something out of cloud benefits that is less ambitious but would be extremely helpful for her particular business?

Accessibility was, on the other hand, more tangible and extremely interesting for Pia. “Just imagine I could be on top of the things from anywhere...” – thought Pia. With the cloud system she would be able to check her accounting processes from any location in the world as long as she had the Internet connection. She could check the status of her company in real-time, using the software at conferences or even at home in her cozy armchair instead of spending long winter evenings at a closed pharmacy, when all her employees had already left home.

Accessibility also solved an important issue of control for Pia. Her main concern with outsourcing of the accounting was her inability to check what the third party accountant does. “Now, with this new cloud system, I can actually outsource the accounting, but at the same time keep my hand on pulse, by being able to check each and every transaction from my phone, or tablet at any given moment” - thought Pia. However, with this luxury, there came a number of problems. “This means I have to share all my data with the software provider, which, from all I know, can be on the other side of the world.” Pia has been following the news, and privacy and data security seemed like a big deal with all these Internet services. Everything from companies misusing customer data to governmental spying seemed to be present, which was not reassuring Pia. “News are news, but is it really worth it to put privacy of my business data at risk?” - she thought.

“And what happens if I want to change my software provider or accountant?” - Pia wondered. The latter according to the representative of accounting company was easy: “All the data and tools are in the cloud, so you can move away from us at any given moment.” However, the fact that “all the data and tools are in the cloud” was almost scary. “But what if I want to change the software? What if the software provider goes out of business? Would it be at all possible to move my stuff to the other vendor?” – Pia had not got proper answers to these questions from her potential software vendors.

After taking a quick glance at the benefits and risks of the cloud, Pia had mixed feelings about the cloud and outsourcing of accounting tasks. Are the benefits worth the risks? Or do the risks of both

outsourcing and cloud outweigh the benefits they can provide? Does cloud and outsourcing suit her company in general?

5 Decision-making problem

Pia Moksi is at the crossroads of important decisions that will affect the fate of her whole company. She needs to find answers to the important questions and define what would be the best solution for her company. She turns to you as a strategy and transformation consultant to help her in analysing the accounting processes at Kluuvin Apteekki and to determine the course of actions that she as the CEO should take regarding these processes. Specifically, she wants you to answer two questions with solid arguments:

Question 1: *Which ones of the accounting tasks - if any - should Pia outsource?*

- *Evaluate each accounting task, on their suitability to outsourcing.*
- *Identify which tasks - if any - should be outsourced to an accounting company.*
- *Develop clear arguments to your decision; both theoretical and practical frameworks are welcome.*

Here, Pia asks you to address the risks and opportunities regarding the outsourcing of accounting processes. There are 22 tasks in accounting that Kluuvin Apteekki needs to do in order to fulfil the internal and external accounting requirements. These 22 tasks vary in terms of their characteristics; some of them are done more frequently than others, some of them require more specific assets, and some of them possess greater level of uncertainty. The set-up here seems to be very close to the theory of Transaction Cost Economics (TCE) (Williamson, 1985). In fact, the fear of opportunistic behaviour from the part of the service provider is something that puzzles Pia and this resonates well with TCE as well. Could TCE be used as a guideline in your analysis? If yes, does that theory hold in the case of standardized accounting services and cloud computing? How does the concept of opportunism fit with today's competitive market for outsourcing of accounting services?

Accounting, in essence, is an information intensive service, which may require a different approach in decision making when combined with the use of information systems. Would the theories on information intensive services be helpful in analysing the case (e.g. Apte, Cavaliere, & Kulkarni, 2010; Apte & Mason, 1995)? Also consider that accounting is a non-core business process, which provides little competitive advantage, thus the considerations in decision-making may be different from core functions.

As discussed in the case, there are different modes of outsourcing available to Pia. In between the extreme choices of total outsourcing or performing all the tasks in-house, there is something called selective outsourcing, meaning the Pia can choose which ones of the tasks she wants to outsource. Is total outsourcing an option for Pia or should Pia go for selective outsourcing (Oshri, Kotlarsky, & Willcocks, 2011)? What other relevant theoretical frames of reference could be used?

Question 2: *Should Pia shift to a cloud-based accounting information system?*

- *Evaluate the benefits and risks associated with cloud-based accounting systems.*
- *Make a suggestion to Pia whether or not to transfer to cloud*

Here, Pia asks you to familiarize yourself with cloud computing and the interplay between cloud computing and accounting services. Develop a clear opinion whether or not to implement cloud-based accounting systems to Kluuvin Apteekki. Consider the use of cloud computing in outsourcing, with potential threats and opportunities that come with it (e.g. Böhm, Leimeister, Riedl, & Krcmar, 2011).

A market of outsourcing a financial administration is highly competitive in Finland. At the moment, more than 4000 independent accounting companies are offering their services, and there are more than 150 information systems that help companies to accomplish the task. A few of those systems are cloud-based accounting information systems, a new breed of systems that offer the whole service and all functionalities over the Internet. Providers of these systems usually operate through the accounting companies that then sell the software forward to their customers in combination with their services. For this reason, the system providers concentrate on the features that would allow the users to outsource their accounting processes and also allow the simultaneous work on the financial administration by multiple parties. While such construct allows client companies to move easily from one accountant to another if needed (provided they work with the same cloud system), companies become highly dependent the of cloud service provider, with all risks that comes with use of such systems.

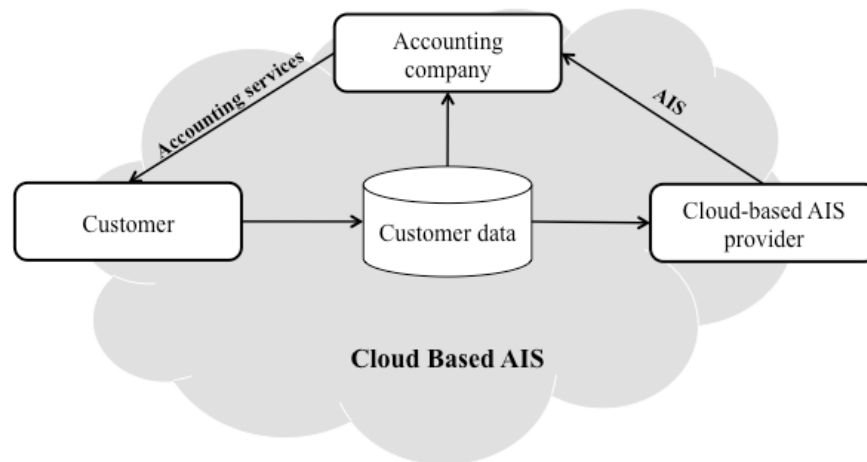


Figure 2. Structure of outsourcing relationship in cloud-based accounting information system

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Appendices

Appendix 1 – Accounting processes in Kluuvin Apteekki

		In-house	Outsourced
Sales	Client register maintenance		
	Product register maintenance		
	Sending sales invoices		
	Handling of sales invoices		
	Sending note of complaint		
	Sales ledger maintenance		
Purchases	Supplier register maintenance		
	Receiving purchase invoices		
	Handling purchase invoices		
	Handling purchase, travel & other costs		
	Purchases ledger maintenance		
Payroll	Personnel register maintenance		
	Basic payroll data maintenance		
	Payroll calculations		
Reporting	Preparation of balance sheet and income statement		
	Preparation and sending of VAT		
	Preparation and sending of annual salary reports		
	Preparation and sending of annual pension insurance reports		
Payments	Periodic VAT payments		
	Salary payments		
	Payments for purchases, travel and other expenses		
	Monthly payroll tax payments		